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SUBJECT: RUSSIA REPORT FOR FINANCIAL CRIMES PORTION OF 2007-2008
INSCR

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¶1. (U) This message is sensitive but unclassified. The tracked changes version of this report will be sent to individuals specified in reftel. Post's point of contact for this report is Economic Officer Clayton Hays (hayscp@state.gov).

¶2. (SBU) Russia's financial system does not attract a significant portion of legal or illegal depositors, and therefore Russia is not considered an important regional financial center. Criminal elements from Russia and neighboring countries continue to use Russia's financial system to launder money because of familiarity with the language, culture, and economic system. The majority of laundered funds do not appear to be from activities related to narcotics production or trafficking, although these activities occur. Experts believe that most of the illicit funds flowing through Russia derive from domestic criminal or quasi-criminal activity, including evasion of tax and customs duties and smuggling operations. Despite making progress in combating financial crime, Russia remains vulnerable to such activity because of its vast natural resource wealth, the pervasiveness of organized crime, and a high level of corruption. Other factors include porous borders, Russia's role as a geographic gateway to Europe and Asia, a weak banking system with low public confidence in it, and under-funding of regulatory and law enforcement agencies. However, due to rapid economic growth in various sectors, the number of depositors has steadily been increasing.

¶3. (U) Russia has recently changed its laws to allow direct foreign ownership and investment in Russian financial institutions. Net private capital inflows for 2007 reached \$82.3 billion according to the Russian Central Bank, an increase from \$41.6 billion in 2006. In contrast to the capital flight that occurred during the 1990s, the majority of more recent outflows involved the legitimate movement of money to more secure and profitable investments abroad, which reflects the maturing of the Russian business sector. However, a portion of this money undoubtedly involved the proceeds of criminal activity. According to official statistics, the trend toward net capital inflows involves the transfer of assets from tax havens, such as Cyprus and the Virgin Islands, previously known to be popular destinations for Russian capital outflows in the 1990s.

¶4. (U) Russia has the legislative and regulatory framework in place to pursue and prosecute financial crimes, including money laundering and terrorism finance. The Russian Federation's Federal Law No. 115-FZ "On Combating Legalization (Laundering) of Criminally Gained Income and Financing of Terrorism" became effective on February 1, 2002, with subsequent amendments to the laws on banking, the securities markets, and the criminal code taking effect in October 2002, January 2003, December 2003, and July 2004, respectively. Law RF 115-FZ obligates banking and nonbanking financial institutions to

monitor and report certain types of transactions, keep records, and identify their customers.

15. (U) According to the original language of RF 115-FZ, institutions legally required to report include: banks, credit organizations, securities market professionals, insurance and leasing companies, the federal postal service, jewelry and precious metals merchants, betting shops, and companies managing investment and nonstate pension funds. Amendments to the law that came into force on August 31, 2004 extend the reporting obligation to real estate agents, lawyers and notaries, and to persons rendering legal or accounting services that involve certain transactions (e.g., managing money, securities, or other property; managing bank accounts or securities accounts; attracting or managing money for organizations; or incorporating, managing, and buying or selling organizations).

16. (U) Various regulatory bodies ensure compliance with Russia's anti-money laundering and counterterrorism finance laws. The Central Bank of Russia (CBR) supervises credit institutions; the Federal Insurance Supervision Service oversees insurance companies; the Federal Service for Financial Markets regulates entities managing nongovernmental pension and investment funds, as well as professional participants in the securities sector; and the Assay Chamber (under the Ministry of Finance) supervises entities buying and selling precious metals or stones.

17. (U) The CBR has issued guidelines regarding anti-money laundering (AML) practices within credit institutions, including "know your customer" (KYC) and bank due diligence programs. Banks are required to obtain and retain for five years information regarding individuals and legal entities and beneficial owners of corporate entities. Banks must also adopt internal compliance rules and procedures and appoint compliance officers. The amendment to Law 115-FZ has required banks to identify the original source of

funds and to report to the financial intelligence unit (FIU) all suspicious transactions since July 2004. Institutions that fail to meet mandatory reporting requirements face revocation of their licenses to carry out relevant activity, limits on certain banking operations, and possible criminal or administrative penalties. An administrative fine of up to \$16,700 can be levied against an institution, with a fine of up to \$700 on an officer of an institution. The maximum criminal penalty is 10 years in prison with applicable fines.

18. (U) All obligated financial institutions must monitor and report to the government: any transaction that equals or exceeds 600,000 rubles (approximately \$22,700) and involves or relates to cash payments, individuals or legal entities domiciled in states that do not participate in the international fight against money laundering, bank deposits, precious stones and metals, payments under life insurance policies, or gambling; all transactions of "extremist organizations" or individuals included on Russia's domestic list of such entities and individuals; and suspicious transactions.

19. (U) Since the CBR issued Order 1317-U in August 2003, Russian financial institutions must now report all transactions with their counterparts in offshore zones. In some cases, offshore banks are also subject to enhanced due diligence and maintenance of additional mandatory reserves to offset potential risks undertaken when conducting specific transactions. The CBR has also raised the standards for offshore financial institutions, resulting in a reduction in the number of such institutions. Overall wire transfers from Russian banks to offshore financial centers have dropped significantly as a result of such regulatory measures.

110. (U) Foreign financial entities, including those from known offshore havens, are not permitted to operate directly in Russia; they must do so solely through subsidiaries incorporated in Russia, which are subject to domestic supervisory authorities. During the process of incorporating and licensing these subsidiaries, Russian authorities must identify and investigate each director of the Russian unit, as nominee or anonymous directors are prohibited under Russian law. In September 2005, the CBR completed its review of all banks that sought admission to the recently established Deposit Insurance System (DIS). To gain admission to the DIS, a bank had to verifiably demonstrate to the CBR that it complies with Russian

identification and transparency requirements. Currently, 911 of Russia's 1,145 banks participate in the DIS.

¶11. (U) By law, Russian businesses must obtain government permission before opening operations abroad, including in offshore zones. A department within the Ministry of Economic Development and Trade (MEDT) reviews such requests from Russian firms, and once the MEDT approves, the CBR must then approve the overseas currency transfer. In either case, the regulatory body responsible for the offshore activity is the same as for domestic activity, i.e., the Federal Service for Financial Markets regulates brokerage and securities firms, while the CBR regulates banking activity.

¶12. (U) Article 8 of Law 115-FZ provides for the establishment of Russia's FIU, called the Federal Service for Financial Monitoring (FSFM). FSFM is an independent executive agency administratively subordinated to the Ministry of Finance. All financial institutions with an obligation to report certain transactions must report the required information to the FSFM. The FSFM is also the regulator for the real estate and leasing, pawnshops, and gaming services sectors. An administrative unit, it has no law enforcement investigative powers. Depending on the nature of the activity, the FSFM provides information to the appropriate law enforcement authorities for further investigation, i.e., the Economic Crimes Unit of the Ministry of Interior (MVD) for criminal matters, the Federal Drug Control Service (FSKN) for narcotics-related activity, or the Federal Security Service (FSB) for terrorism-related cases.

¶13. (U) In June 2005, President Putin approved a national strategy for combating money laundering and terrorism finance, part of which called for the creation of a new Interagency Commission on Money Laundering, comprised of twelve ministries and government departments. In addition to receiving, analyzing and disseminating information from the reporting entities, the FSFM has the responsibility of implementing the state policy to combat money laundering and terrorism financing. The Interagency Commission is chaired by the head of the FSFM and is responsible for monitoring and coordinating the government's activity on money laundering and terrorism financing. FSFM authorities credit cooperation among Commission members for the conviction of 257 individuals on money laundering charges between January and June 2006.

¶14. (U) Nearly all financial institutions submit reports to the FSFM via encrypted software provided by the FSFM. According to

press reports, Russia's national database contains over four million reports involving operations and deals worth approximately \$900 billion. The FSFM estimates that Russian citizens may have laundered as much as \$11 billion in 2007. The FSFM receives approximately 30,000 transaction reports daily. Of these daily reports, 25 percent result from mandatory (currency) transaction reports, and 75 percent relate to suspicious transactions.

¶15. (U) Each of the FSFM's seven territorial offices corresponds with one of the federal districts that comprise the Russian Federation. The Central Federal District office is headquartered in Moscow; the remaining six are located in the major financial and industrial centers throughout Russia (St. Petersburg, Ekaterinburg, Nizhny Novgorod, Khabarovsk, Novosibirsk and Rostov-on-Don). The territorial offices coordinate with regional law enforcement and other authorities to enhance the information flow into the FSFM, and to supervise compliance with anti-money laundering and counterterrorism financing legislation by institutions under FSFM supervision. Additionally, the satellite offices must identify and register at the regional level all pawnshops, leasing and real estate firms, and gaming entities under their jurisdiction. The regional offices also are charged with coordinating the efforts of the CBR and other supervisory agencies to implement anti-money laundering and counterterrorist financing regulations. Russia's anti-money laundering law, as amended, provides the FSFM with the appropriate authority to gather information regarding the activities of investment foundations, nonstate pension funds, gambling businesses, real estate agents, lawyers and notaries, persons rendering legal/accountancy services, and sellers of precious metals and jewelry.

¶16. (U) During the first half of 2007, the FSFM registered 5,603 crimes involving money laundering, compared to 7,957 reports for all

of 2006. Interior Ministry officials reported that 4,535 of the 2007 cases went to trial. Both the FSFM and MVD report that the number of suspicious transaction reports for the year roughly equaled those of 2006 and credit increased cooperation among law enforcement agencies for the number of cases brought to trial.

¶117. (U) As part of administrative reforms enacted in 2004, the FSKN now has a full division committed to money laundering, staffed by agents with experience in counter narcotics and economic crimes. This division cooperates closely with the FSFM in pursuing narcotics-related money laundering cases. The FSKN reported that during 2007 it referred 14 cases of money laundering more than \$60 million for prosecution. Consistent with Financial Action Task Force (FATF) recommendations, the criminal code was amended in December 2003 to remove a specific monetary threshold for crimes connected with money laundering, thus paving the way for prosecution of criminal offenses regardless of the sum involved.

¶118. (U) With its legislative and enforcement mechanisms in place, Russia has begun to prosecute high-level money laundering cases. During 2007, the CBR revoked the licenses of 44 banks for failing to observe banking regulations. Of these, 30 banks lost their licenses for violating Russia's anti-money laundering laws. Central Bank First Deputy Chairman Andrey Kozlov's effort to prohibit individuals convicted of money laundering from serving in leadership positions in the banking community remains a pending issue in the CBR.

¶119. (U) Russian legislation provides for the tracking, seizure and forfeiture of criminal proceeds. None of this legislation is specifically tied to narcotics proceeds. Legislation provides for investigative techniques such as search, seizure, and the identification, freezing, seizing, and confiscation of funds or other assets. Authorities can also compel targets to produce documents. Where sufficient grounds exist to suppose that property was obtained as the result of a crime, investigators and prosecutors can apply to the court to have the property frozen or seized. Law enforcement agencies have the power to identify and trace property that is, or may become, subject to confiscation or is suspected of being the proceeds of crime or terrorist financing. The law allows the FSFM, in concert with banks, to freeze possible terrorist-related financial transactions for one week: banks may freeze transactions for two days, and the FSFM may follow up with freezing for an additional five days.

¶120. (U) In accordance with its international agreements, Russia recognizes rulings of foreign courts relating to the confiscation of proceeds from crime within its territory and can transfer confiscated proceeds of crime to the foreign state whose court issued the confiscation order. However, Russian law still does not provide for the seizure of instruments of crime. Businesses can be seized only if it can be shown that they were acquired with criminal proceeds. Legitimate businesses cannot be seized solely on the basis that they were used to facilitate the commission of a crime.

¶121. (U) The Presidential Administration as well as Russian law enforcement agencies have expressed concern about ineffective implementation of Russia's confiscation laws. The government has proposed amendments that are currently under review by the Duma (Parliament) which would make it easier to identify and seize criminal instrumentalities and proceeds. While Russian law enforcement has adequate police powers to trace assets, and the law permits confiscation of assets, most Russian law enforcement personnel lack experience and expertise in these areas.

¶122. (U) The Russian Federation has enacted several pieces of legislation and issued executive orders to strengthen its ability to fight terrorism. On January 11, 2002, President Putin signed a decree entitled "On Measures to Implement the UN Security Council Resolution (UNSCR) No. 1373 of September 28, 2001." Noteworthy among this decree's provisions are the introduction of criminal liability for intentionally providing or collecting assets for terrorist use, and the instructions to relevant agencies to seize assets of terrorist groups. When this latter clause conflicted with existing domestic legislation, the Duma within the year approved an amendment to the anti-money laundering law, resolving the conflict and allowing banks to freeze assets immediately pursuant to UNSCR ¶1373. Article 205.1 of the criminal code, enacted in October 2002,

criminalizes terrorist financing. On October 31, 2002, the Federation Council, Russia's upper house, approved a supplemental article to the 2003 federal budget, allocating from surplus government revenues an additional 3 billion rubles (\$1.1 million) in support of federal counterterrorism programs and improvement of national security.

¶23. (U) The FSFM reports that in regard to terrorism financing, it has compiled a list of 1,300 organizations and individuals suspected of financing terrorism, 400 of which were foreign. There are five sources of information that may designate entities for inclusion on the FSFM's list of proscribed organizations. International organizations' designations, such as the UN 1267 Sanctions Committee, constitute the first source. Second, Russian court decisions provide a basis for inclusion. Third, resolutions from the Prosecutor General can identify individuals and organizations for inclusion. Fourth, Ministry of Interior investigations serve as a basis for inclusion if subsequent court decisions do not dismiss the investigation's findings. Finally, bilateral agreements, which include information sharing regarding entities on the counterpart's entities list, may provide a basis for inclusion on the FSFM list.

¶24. (U) At the request of the General Procuracy, the Russian Supreme Court has, to date, authorized an official list of 17 terrorist organizations. According to press reports, this designation allows Russian law enforcement agencies to seize the organizations' financial assets immediately, whereas the FSFM designation provides a basis for financial institutions to include information about the organizations in suspicious transaction reports. Although Russia has actively assisted the U.S. in investigating cases involving terrorist financing, Russia and the U.S. continue to differ about the purpose of the UN 1267 Sanctions Committee's designation process. These political differences have hampered bilateral cooperation in this forum.

¶25. (U) The United States and Russia signed a Mutual Legal Assistance Treaty in 1999, which entered into force on January 31, 2002. The FSFM has signed cooperation agreements with the Financial Intelligence Units (FIUs) of 24 countries, including the United States. The FSFM has been an active member of the Egmont Group since June 2002, having sponsored candidate FIUs from the former Soviet republics, including current FIU members in Ukraine and Georgia. U.S. law enforcement agencies exchange operational information with their Russian counterparts on a regular basis. In 2005, Russian law enforcement agencies cooperated with the U.S. in a high-profile case that led to the conviction of a Russian national in a U.S. District Court on charges that he laundered over \$130 million through a Moscow bank. The individual was sentenced to 51 months imprisonment and ordered to pay \$17.4 million in restitution to the Russian government. This close cooperation between Russian and U.S. agencies has continued and strengthened in 2006.

¶26. (U) Russia became a full member of the Financial Action Task Force in June 2003 and participates as an active member in two FATF-style regional bodies. It is a member of the Council of Europe's Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL) and was instrumental in the creation of the Eurasian Group on Combating Legalization of Proceeds from Crime and Terrorist Financing (EAG). The EAG Secretariat is located in Moscow. In December 2005, under the auspices of the EAG, the FSFM established the International Training and Methodological Center of Financial Monitoring (ITMCFM). The main function of the Center is to

provide technical assistance to EAG member-states, primarily in the form of staff training for FIUs and other interested ministries and agencies involved in AML/CFT efforts. The ITMCFM also conducts research on AML/CFT issues. As Chairman of the EAG, Russia's FIU continues to play a strong leadership role in bringing the region up to international standards in its capacity to fight money laundering and terrorism financing.

¶27. (U) Russia ratified the Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime in January 2001. Russia is a party to the 1988 UN Drug Convention and on May 26, 2004, became a party to the UN Convention against Transnational Organized Crime. In November 2002, Russia ratified the UN International Convention for the Suppression of the Financing of Terrorism. Russia also became a signatory to, and

ratified on May 9, 2006, the UN Convention against Corruption.

¶28. (U) Through aggressive enactment and implementation of comprehensive money laundering and counterterrorism financing legislation, Russia now has well-established legal and enforcement frameworks to deal with money laundering and terrorism financing. Given its role in the creation and maintenance of the EAG, Russia has also demonstrated the will and capability to improve the region's capacity for countering money laundering and terrorism financing.

¶29. (U) Nevertheless, serious vulnerabilities remain. Russia is among the world's most sophisticated perpetrators of fraud and money laundering through electronic and internet-related means. To meet its goal of combating money laundering and corruption, Russia needs to follow through on its commitment to improve CBR oversight of shell companies and scrutinize more closely those banks that do not carry out traditional banking activities, including making all offshore operations subject to the identical due diligence and reporting requirements as other sectors. To prevent endemic corruption and deficiencies in the business environment from undermining Russia's efforts to establish a well-functioning anti-money laundering and counterterrorism finance regime, Russia should strive to stamp out official corruption, particularly at high levels, and to increase transparency in the financial sector and the corporate environment. Russia should also commit adequate resources to its regulatory and law enforcement entities in order to help them fulfill their responsibilities. Additionally, Russia should work to increase the effectiveness of its confiscation laws and their implementation including enacting legislation providing for the seizure of instruments, in addition to the proceeds, of criminal activity. Finally, Russia should continue to play a leadership role in the region with regard to anti-money laundering and counterterrorist finance implementation.

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